

D.P.U. 92-235

Petition of the Massachusetts Municipal Wholesale Electric Company ("MMWEC") requesting approval by the Department of Public Utilities for borrowing by the issuance of bonds or other forms of indebtedness in total principal amount not exceeding \$504,420,000, Refunding Bonds, solely for the purpose of refunding up to an aggregate amount of \$430,290,000 of outstanding Power Supply System Revenue Bonds for Nuclear Project No. 3, Nuclear Project No. 4, Nuclear Project No. 5, 1987 Series A; Stony Brook Intermediate Project 1979 Series A; Nuclear Project No. 4 and Nuclear Project No. 5, 1978 Series A and 1987 Series A; and Nuclear Mix No. 1, 1976, Series A, Refunded Bonds, including deposits required by MMWEC's General Bond Resolution in connection therewith and for revocation of previously issued but unusable Refunding Bond authority for Nuclear Project No. 3, Nuclear Project No. 4, Nuclear Project No. 5, Project 6, the Stony Brook Intermediate Project and the Stony Brook Peaking Project.

APPEARANCES: Nicholas J. Scobbo, Jr. Esq.
Lynn Peterson Read, Esq.
Ferriter, Scobbo, Sikora
Singal, Caruso & Rodophele
One Beacon Street
Boston, Massachusetts 02108
FOR: MASSACHSETTS MUNICIPAL WHOLESALE
ELECTRIC COMPANY
Petitioner

I. INTRODUCTIONA. Procedural History

On October 19, 1992, the Massachusetts Municipal Wholesale Electric Company ("MMWEC" or "Company") filed with the Department of Public Utilities ("Department") a petition requesting approval of borrowing by the issuance of bonds or other forms of indebtedness in total principal amount not exceeding \$504,420,000 for the purpose of refunding up to an aggregate amount of \$430,290,000 of outstanding Power System Revenue Bonds described as follows: (1) Nuclear Project No. 3 ("Project 3"), 1987 Series A; (2) the Stony Brook Intermediate Project, 1979 Series A ("Stony Brook Project"); (3) Nuclear Project No. 4 ("Project 4"), 1978 Series A and 1987 Series A; (4) Nuclear Project No. 5 ("Project 5"), 1978 Series A and 1987 Series A; and (5) Nuclear Mix No. 1 ("Mix 1"), 1976 Series A (hereinafter collectively referred to as "the Projects")¹. The approved borrowing also would be used to pay issuance expenses and deposits required by MMWEC's general bond resolution ("GBR") in connection with the borrowings.

As part of its filing, MMWEC also requested that the Department revoke \$174,556,500 in unusable refunding authority previously authorized by the Department (Exh. M-1, p. 42).

The Department designated Andrew O. Kaplan as hearing

¹ Refunding Bonds are debt instruments issued to retire outstanding bonds. Refunded Bonds are those instruments retired by the issuance of refunding bonds.

officer. Paul E. Osborne, of the Department's Rates and Revenues Division, provided technical assistance.

Pursuant to notice duly issued, an evidentiary hearing was held at the Department's offices in Boston on November 23, 1992. No petitions for leave to intervene were filed. John D. Miller of the financial advisory firm of Public Finance Management, Inc. ("PFM") testified in support of MMWEC's petition. MMWEC introduced two exhibits. The first exhibit was the prefiled direct testimony of Mr. Miller together with seven attachments (Exh. M-1). The second exhibit was MMWEC's Official Statement issued in connection with its issuance of its 1992 Series D, E, and F Bonds (Exh. M-2). The Company filed a brief on December 1, 1992.

B. MMWEC

MMWEC was created by Chapter 775 of the Acts of 1975 and is a public instrumentality and a political subdivision of the Commonwealth. St. 1975, c. 775, § 1et seq.; G.L. c. 164, App. § 1-1, et seq.; Massachusetts Municipal Wholesale Electric Company, D.P.U. 86-57, p. 2 (1986). MMWEC is a public corporation formed to develop a bulk power supply program for Massachusetts municipal electric systems, with authority to acquire, construct, and finance ownership interest in electric generating units. St. 1975, c. 775, § 5; G.L. c. 164, App., § 1-5. It does so, in part, through the issuance of revenue bonds. Massachusetts Municipal Wholesale Electric Company, et al. v. Town of Danvers et al., 411 Mass. 39 (1991).

C. The Projects

While MMWEC owns undivided interests in its generating facilities assets, it sells the capacity and energy from these ownership interests to various Massachusetts municipal electric systems and out-of-state utilities through a planning and acquisition vehicle referred to as a project (Exh. M-1, p. 8). The utilities execute power sales agreements ("PSAs"²) with MMWEC for their purchase of the capacity and energy output, if any, of a project (id.). MMWEC has eight projects through which it sells capacity and energy to 28 Massachusetts municipal electric systems and seven out-of-state utilities (Exh. M-2).

Project 3 consists of a 3.196 percent ownership interest in Millstone 3, a 1,150 megawatt ("MW") nuclear generating unit located in Waterford, Connecticut. MMWEC sells the capacity and energy from this ownership interest to 27 municipalities (Exh. M-1, pp. 8-9). Project 4 and Project 5 consist of a 4.333 percent and 1.097 percent interest, respectively, in Seabrook Unit 1, a 1,150 MW nuclear generating unit located in Seabrook, New Hampshire. MMWEC sells the capacity and energy from these

² The PSAs establish the portion of project capability for which each project participant contracted and sets out the obligations of MMWEC and each participant. In general, the PSA obligates the participants to pay their pro rata share of all expenses incurred by MMWEC in relation to the project, including any principal and interest obligations incurred as a result of debt issued by MMWEC to support the project. Each participant is required by the terms of the PSA to fix electric rates sufficient to provide revenues to meet its obligations under the PSA. Massachusetts Municipal Wholesale Electric Company D.P.U. 86-57, p. 3 (1986).

ownership interests to 27 municipalities for Project 4 and 28 municipalities for Project 5 (id., pp. 8-9). The Stony Brook Project consists of a 90.757 percent ownership interest in a 343 MW oil and gas combined-cycle facility located in Ludlow, Massachusetts. MMWEC sells the capacity and energy from these ownership interests to 24 municipalities and six out-of-state participants (id., pp. 10-11). Mix 1 consists of a 1.603 percent and 0.163 percent ownership interest in Millstone No. 3 and Seabrook, respectively. MMWEC sells the capacity and energy from these ownership interests to 25 municipalities (id., p. 10).

II. STANDARD OF REVIEW

In order for the Department to approve the issuance of bonds by MMWEC, the Department must determine that the proposed borrowing is reasonably necessary to accomplish some legitimate purpose in meeting MMWEC's service obligations, pursuant to St. 1975, c. 775, § 17, as amended by St. 1981, c. 105.

Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) (Fitchburg II), citing Fitchburg Gas and Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (Fitchburg I).⁴

³ St. 1981, c. 105 amended St. 1975, c. 775, § 17, by adding the provision that Department approval is not required for the issuance by MMWEC of bonds with a maturity of one year or less. See G.L. c. 164 App., § 1-17.

⁴ The court has found that the authority of the Department under St. 1975, c. 775, § 17, to determine whether a proposed issuance of bonds by MMWEC is "reasonably necessary" is of the same scope as the Department's authority in making such a determination for electric and
(continued...)

St. 1975, c. 775, § 11, provides, in pertinent part:

[MMWEC] may issue refunding bonds for the purpose of paying any of its bonds at maturity or upon acceleration or redemption, subject to the approval of the [D]epartment under this act.

St. c. 1981, c. 105, provides, in pertinent part:

[MMWEC] shall issue only such amount of bonds as the [D]epartment may from time to time vote is reasonably necessary for the proposed purpose of such issue, and such approval shall be subject to such reasonable terms and conditions as the [D]epartment may determine to be in the public interest; provided, however, that where such bonds are payable at period of not more than one year after the date of issue, approval of such issuance by the [D]epartment shall not be required.

The courts have found that, for the purposes of G.L. c. 164, § 14 and St. 1975, c. 775, § 17, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II, citing Lowell Gas Light Company v. Department of Public Utilities 319 Mass 46, 52 (1946) ("Lowell Gas").

The Fitchburg and Lowell Gas cases also established that the burden of proving that an issuance is reasonably necessary rests with the company proposing the issuance and that the Department's

⁴(...continued)

gas companies under G.L. c. 164, § 14. Fitchburg II, at 841-843. Since the standard of "reasonably necessary" was not affected by the enactment of St. 1981, c. 105, we find that the Department's authority, except regarding short-term bond issuances, remains the same under St. 1981, c. 105, as it was under St. 1975, c. 775, §17. Massachusetts Municipal Wholesale Electric Company D.P.U. 89-230, p. 10, n.4 (1992).

authority to review a proposed issuance "is not limited to a `perfunctory review.'" Fitchburg I at 678; Fitchburg II at 842, citing Lowell Gas at 52.

In cases where no issue exists about whether the management decisions regarding the requested financing were the result of a reasonable decision-making process, the Department limits its review to the question of whether proceeds from an issuance will be used for a purpose that, on its face, is reasonable. Canal Electric Company et al, D.P.U. 84-152, p. 20 (1984).

III. MMWEC'S PROPOSAL

A. Refunding Bonds

The Company has financed its ownership interests in various generating facilities through revenue bonds issued under its General Bond Resolution ("GBR") and pursuant to c. 775 of the Acts of 1975 (Exh. M-1, p. 7).

MMWEC has petitioned the Department for approval to borrow funds, by the issuance of bonds or other forms of indebtedness, not to exceed \$246,825,000 for MMWEC's Projects 3, 4, and 5;

\$129,940,000 for its Stony Brook Project; \$66,050,000 for its Projects 4 and 5; and \$61,605,000 for MMWEC's Mix 1 (hereinafter collectively referred to as "Refunding Bonds") id., pp. 5-6).

The aggregate amount of bonds sought to be issued is \$504,420,000 (id., p. 5).

The purpose of this debt issuance would be to refund in the aggregate \$430,290,000 associated with the Company's Projects 3, 4, 5, the Stony Brook Project, and Mix 1 (Exh. M-1, p. 8). The

specific bonds to be refunded through these issuances ("Refunded Bonds") include \$196,115,000 of MMWEC's Power Supply System Revenue Bonds, 1987 Series A, issued to finance the costs associated with Projects 3, 4, and 5; \$118,125,000 of MMWEC's Power Supply System Revenue Bonds, 1979 Series A, used to finance the costs associated with the Stony Brook Project; \$60,045,000 of MMWEC's Power Supply System Revenue Bonds, 1978 Series A used to finance the costs associated with Projects 4 and 5; and \$56,005,000 of MMWEC's Power Supply System Revenue Bonds, 1976 Series A, used to finance the costs associated with Mix 1 (Exh. M-1, pp. 11-12).

B. Refunded Bonds

According to Mr. Miller, there are essentially two methods by which bonds could be refunded: (1) advance refunding or (2) current refunding (Exh. M-1, p. 12). Under advance refunding, MMWEC would issue Refunding Bonds, the proceeds of which would be used to purchase United States Treasury obligations ("Treasury obligations"). The Treasury obligations would then be placed in an irrevocable escrow account maintained by the Company's bond fund trustee id.). After the escrow account is established, the lien on MMWEC's revenues, as created by the GBR, would be defeased and the Refunded Bonds would no longer be considered outstanding under the GBR id., pp. 12-13, 24). Instead, the Refunded Bonds would be secured by the Treasury obligations in the escrow account (Exh. M-1, p. 13). The interest and principal coming due on these obligations are

matched to the interest and principal coming due on the Refunded Bonds prior to and at their first call date, and would be escrowed until the first date at which the Refunded Bonds may be called for redemption (id., p. 14).

Under a current refunding, MMWEC would instruct its bond fund trustee to redeem the Refunded Bonds within 30 to 90 days after MMWEC receives the proceeds from its Refunding Bonds (Exh. M-1, p. 14). An escrow fund would be established in the same manner as for an advance refunding, but would only be in existence for the duration of the 30- to 90-day escrow period required (id., p. 15).

As noted supra, the Company seeks authority to refund all of the \$118,125,000 outstanding 1979 Series A Bonds, \$60,045,000 of outstanding 1978 Series A Bonds, and \$56,005,000 outstanding 1976 Series A Bonds (Exh. M-1, p. 11). All of these bonds currently are callable (id.). MMWEC also seeks authority to refund its total \$196,115,000 outstanding 1987 Series A bonds, which are callable on or after July 1, 1997 (Exh. M-1, p. 11). The Company intends to advance refund its 1987 Series A bonds, and anticipates that it currently would refund its 1976 Series A, 1978 Series A, and 1979 Series A bonds (id., p. 12).

MMWEC has requested a ten percent contingency for refunding its 1976 Series A, 1978 Series A, 1979 Series A, and 1987 Series A bonds (Exh. M-1, p. 16). According to the Company, a ten percent contingency would provide enough financial flexibility to allow MMWEC to obtain the lower interest rate without the need

for additional bonding approval from the Department id., p. 21)). MMWEC also reported that under an advance refunding, the addition of a contingency increases the net present value of the savings associated with lower debt service costs id., pp. 21-22)). The Company noted that in a current refunding, it could structure the Refunding Bonds to achieve additional savings id., p. 22)). Finally, MMWEC maintained that a contingency would permit the Company to advance refund additional Refunded Bonds, dependent on market conditions (id.).

C. Anticipated Savings

MMWEC seeks authority to issue its Refunding Bonds in order to lower its debt service payments by taking advantage of historically low municipal market interest rates, improve the creditworthiness of the Company, and produce rate amelioration for Project participants (Exh. M-1, p. 29). According to the Company, savings resulting from lower debt service payments would be passed on to Project participants through reduced billings under the PSAs for the Projects id., p. 7).

The Company testified that refunding its 1979 Series A bonds would produce present value savings over the current bonds of 2.65 percent. Refunding the 1978 Series A bonds would produce net savings of 0.010 percent, and refunding the 1976 Series A bonds would produce net savings of 5.02 percent (Exh. M-1, p. 30). MMWEC considered a 5 net savings generally to justify refunding (id., pp. 29-30). As a result of the refunding, the Company estimated that its annual debt service would decline by

approximately \$2,975,000 on an average annual basis, and by \$22,811,000 on an aggregate present value basis, for Projects 3, 4, 5, Mix 1, and the Stony Brook Projects (Exh. M-1, Att. 7).

Mr. Miller included in his savings analysis an allowance for issuance costs based on two percent of the issue size of the Refunding Bonds (Exh. M-1, p. 20). Issuance costs consists of underwriting discounts, bond counsel and other legal fees, printing expenses, consulting engineer's fees, financial advisory fees, and trustee fees id., p. 21).

D. Variable Rate Debt

The Company proposed that the Department permit MMWEC to explore the feasibility of using more innovative techniques to lower the cost of debt. MMWEC proposed the use of variable rate debt (Exh. M-1, pp. 31-39).

In support of this proposal, the Company contends that current interest rates are low, that historical comparisons of variable-rate debt to fixed-rate debt is also low, and that while variable-rate debt has at times exceeded MMWEC's current fixed rate, the difference was minimal and of short duration (Company Brief, p. 26). MMWEC argues that its Projects were capitalized in the 1970s and early 1980s through a strategy based on 100 percent long-term debt financing, because there was no viable variable-rate market, interest rates were increasing, and tax laws of the period permitted unlimited arbitrage on debt-financed liquid assets, as represented by MMWEC's revenue bondsid.,

pp. 27-28). The Company contends that current market and financial conditions make variable-interest rates viable, such as the presence of a large tax-exempt, variable-rate debt market, changes in tax laws, and the general decline in interest rates (id., p. 28). Pursuant to its GBR, MMWEC has funds and temporary investments of approximately \$250,000,000, being financed at the Company's average cost of debt, 7 percent per annum (id.). Because these assets are invested in short-term government securities currently earning 5.5 percent per annum, MMWEC contends it is exposed to interest risk which is further exasperated by new arbitrage regulations (id.).⁵

E. Unusable Refunding Authority

The Department has permitted MMWEC to issue refunding bonds solely for the purpose of refunding specific bond obligations. For example, MMWEC was authorized to refund its 1981 Series B, 1982 Series A, 1982 Series B, 1984 Series A, and 1985 Series A bonds associated with Project 3 through the issuance of its 1987 Series A, and 1992 Series A, B, and E Bonds. See Massachusetts Municipal Wholesale Electric Company D.P.U. 85-274 (1986). MMWEC has remaining \$19,515,000 of refunding bond authority that was not needed at the time it issued its refunding bonds in 1987 and 1992 (Exh. M-1, p. 39).

Additionally, the Department has permitted MMWEC to issue

⁵ In future financing petitions where MMWEC seeks approval for the use of a variable interest rate, MMWEC shall propose a maximum variable interest rate and shall provide an analysis to support this maximum rate.

its 1987 Series A, 1992 Series A, B, and E Bonds solely for the purpose of refunding its 1982 Series A, 1982 Series B, and 1984 Series A bonds associated with Projects 4 and 5. Massachusetts Municipal Wholesale Electric Company D.P.U. 86-57 (1986).

MMWEC has remaining \$18,147,500 and \$7,606,250 of Refunding Bond authority for Projects 4 and 5, respectively, that was not needed at the time it issued its Refunding Bonds in 1987 and 1992 (Exh. M-1, p. 40).

Moreover, the Department also permitted MMWEC to issue its 1992 Series A, B, C, D, E and F Bonds solely for the purpose of refunding its 1981 Series A, 1981 Series B, 1982 Series A, 1982 Series B, 1984 Series A, 1985 Series B, and 1987 Series B bonds associated with Project 6. Massachusetts Municipal Wholesale Electric Company, D.P.U. 89-230 (1992); Massachusetts Municipal Wholesale Electric Company D.P.U. 86-57 (1986). MMWEC has remaining \$126,962,750 of refunding bond authority for Project 6 that was not needed at the time it issued its refunding bonds in 1992 (Exh. M-1, p. 41).

Finally, the Department has permitted MMWEC to issue its 1992 Series E Bonds solely for the purpose of refunding its 1980 Series A bonds associated with the Stony Brook Project and Stony Brook Peaking Project. Massachusetts Municipal Wholesale Electric Company, D.P.U. 89-230 (1992). MMWEC has remaining \$205,000 and \$1,720,000 of refunding bond authority for the Stony Brook Project and the Stony Brook Peaking Project, respectively, that was not needed at the time it issued its refunding bonds in

1992 (Exh. M-1, p. 41).

In summary, MMWEC currently has \$174,556,500 in bond authority outstanding that was not needed at the time it refunded its previous bond obligations. Because the Department specifically limited MMWEC's ability to issue refunding bonds solely for the purpose of refunding specific outstanding MMWEC bond obligations, MMWEC is unable to use the remaining bond authority that was permitted, but never required. In order to avoid potential confusion or potential problems that may arise as to MMWEC's authority to issue future bonds, the Company requests that the Department revoke that portion of the remaining bond authority that cannot be used by MMWEC in the future (Exh. M-1, p. 42). Mr. Miller explained that because rating agencies and investors look at MMEWC's outstanding bond authority, revocation of the unusable bond authority would clarify MMWEC's issuing authority to these outside parties (Tr. 13).

III. ANALYSIS AND FINDINGS

The evidence demonstrates that the proposed refunding will result in debt service savings and, in turn, savings to the Projects' participants. Based on the foregoing evidence, the Department finds that MMWEC has sufficiently demonstrated that the proposed refunding will be used for a purpose that is reasonably necessary to accomplish the Company's utility operations in accordance with St. 1981, c. 105, and that the decision-making process underlying this proposal is based on a consideration of appropriate factors.

Issues concerning the prudence of the Company's capital financing have not been raised in this proceeding, and the Department's decision in this case does not represent a determination that any project is economically beneficial to the Company or its participants.

Furthermore, the Department finds that it is appropriate to revoke MMWEC's authority to issue that portion of the refunding bond authority that remains and cannot be used by the Company.

Regarding the issue of variable debt, the Department finds that while variable interest rates entail the assumption of greater risk by the issuer, the Company has demonstrated that prevailing market conditions and financial regulations may reasonably make the issuance of variable-rate debt beneficial to MMWEC and its Project participants (Exh. M-1, pp. 36-37). Accordingly, the Department finds that the use of tax-exempt, variable-rate debt likely would (i) reduce MMWEC's cost of capital, (ii) facilitate a positive spread between the cost of variable-rate debt and the Company's earnings capability on its liquid assets, and (iii) lower the Company's fixed-rate borrowing costs.

IV. ORDER

Accordingly, after due notice, hearing, and consideration, the Department hereby:

VOTES: That the issuance, from time to time, by the Massachusetts Municipal Wholesale Electric Company of Refunding Bonds and temporary notes, bonds, or other evidences of

indebtedness in principal amounts not in excess of those specified in its petition is reasonably necessary for the proposed purpose of such issue(s); and

FURTHER VOTES That the revocations of certain previously authorized, but unusable, refunding bond authority as specified in the petition of the Massachusetts Municipal Wholesale Electric Company is consistent with the public interest; and it is

ORDERED: That the Department approves the borrowing by the Massachusetts Municipal Wholesale Electric Company, from time to time, by the issuance of Refunding Bonds (and temporary notes, bonds, or other evidences of indebtedness) in an aggregate principal amount not exceeding \$504,420,000 to be used solely for the purpose of refunding up to an aggregate \$430,290,000 of (i) Massachusetts Municipal Wholesale Electric Company's tax-exempt 1987 Series A Power Supply System Revenue Bonds for Nuclear Project No. 3, Nuclear Project No. 4, and Nuclear Project No. 5; (ii) tax-exempt 1979 Series A Power Supply System Revenue Bonds for the Stony Brook Intermediate Project; (iii) tax-exempt 1978 Series A Power Supply System Revenue Bonds for Nuclear Project No. 4; (iv) tax-exempt 1978 Series A Power Supply System Revenue Bonds for Nuclear Project No. 5; and (v) tax-exempt 1976 Series A Power Supply System Revenue Bonds for Mix No. 1; including issuance expenses and deposits required by Massachusetts Municipal Electric Company's General Bond Resolution in connection therewith; and it is

FURTHER ORDERED That the Massachusetts Municipal Wholesale

Electric Company may structure the Refunding Bonds (and temporary notes, bonds, or other evidences of indebtedness) to be issued pursuant to this Order in any manner the Massachusetts Municipal Wholesale Electric Company determines to be appropriate, including the use of a variable rate debt; and it is

FURTHER ORDERED That previously approved, but unusable, refunding bond authority, as specified in the petition of the Massachusetts Municipal Wholesale Electric Company, for Nuclear Project No. 3, Nuclear Project No. 4, Nuclear Project No. 5, Project No. 6, the Stony Brook Intermediate Project, and the Stony Brook Peaking Project, be and is hereby revoked.

By Order of the Department,